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No. 87-1047

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

NATIONWIDE CORPORATION AND
NATIONWIDE MUTUAL INSURANCE COMPANY,
Petitioners,

v.

HOWING COMPANY AND
DOUGLAS MCLELLAN,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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SUPPLEMENTAL BRIEF FOR PETITIONERS

JEFFREY S. DAVIDSON
(Counsel of Record)
DANIEL F. ATTRIDGE
YOSEF J. RIEMER
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000
Counsel for Petitioners Nationwide Corporation and Nationwide Mutual Insurance Company

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SUPPLEMENTAL BRIEF FOR PETITIONERS

ARGUMENT

The government's brief simply ignores the far-reaching conclusion of the Sixth Circuit that all statutes passed before 1975 presumptively create private causes of action. Instead, the government takes an equally novel and unsupportable position: that the now limited and severely questioned decision in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), gives rise to an implied cause of action for Rule 13e-3 violations. While the Sixth Circuit and government disagree, both propose analyses that would spawn hosts of new implied causes of action in violation of the controlling standard announced in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979), and *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

The government's theory that the Sixth Circuit need not have decided if Section 13(e) of the Securities Exchange Act created a private cause of action and instead should have found a Section 14(a) violation suggests an unreachable result in the current posture of this case. The Sixth Circuit held as a matter of law that Nationwide's proxy statement did not violate Section 14(a), and based its Rule 13e-3 decision on finding a private right of action under Section 13(e). Thus, the reality is that the question suggested by Nationwide for review by this Court is in fact presented by this case—whether or not the government believes it "should" have been.

Indeed, the government's new theory only highlights the need for certiorari to resolve the apparent confusion in the law in an area involving over $20 billion in securities transactions each year. Although federal courts have divided over whether Section 13(e) creates a private cause of action, no court has ever thought that Section

14(a) controlled whether damages are available for alleged violations of Rule 13e-3, as the government now asserts. And with good reason. Such a rationale is contrary to the legislative history of Section 13(e), the history of the promulgation of Rule 13e-3, and the SEC's own historical position on the source of any private right of action in the context of going-private mergers.

The government in effect argues for an expansion of *J.I. Case Co. v. Borak* to sanction private damages actions in cases which involve no false or misleading proxy statements. The government's position again points out the appropriateness of granting certiorari. The proper scope of *Borak* should be delineated, especially in light of the more restrictive standard for creating private causes of action announced in subsequent cases.

I. THE GOVERNMENT'S RELIANCE ON SECTION 14(a) IS CONTRARY TO THE UNCHALLENGED HOLDING BELOW, EVERY RULE 13e-3 CASE, AND THE PERTINENT LEGISLATIVE AND REGULATORY HISTORY.

A. Reliance On Section 14(a) Is Precluded By The Sixth Circuit's Holding Of No 14(a) Violation.

In seeking to avoid the Section 13(e) question decided by the Sixth Circuit, the government maintains the court should have decided the case by finding a Section 14(a) violation. But that result is unreachable in the case at bar.

The Sixth Circuit held as a matter of law that Nationwide's proxy statement did not violate Section 14(a). (24a.) Neither petitioners nor respondents sought review of that holding in this Court. At most, the government's position that the Sixth Circuit should have found a Section 14(a) violation merely points out that even the government disagrees with the court below.

B. No Prior Rule 13e-3 Decision Has Relied On Section 14(a).

As the government acknowledges, four federal courts have divided over whether private litigants can seek damages for violations of Rule 13e-3. (Brief for United States at 8 n.7.) No court (including the Sixth Circuit) has ever thought that Section 14(a) controlled the issue. On this issue, the Sixth Circuit did not err. As shown below, the legislative history of Section 13(e), the history of Rule 13e-3, and the SEC's own historical position all demonstrate that the availability of private actions to enforce Rule 13e-3 is properly analyzed under Section 13(e). The confusion in the case law over the result under Section 13(e) and the role, if any, of Section 14(a) underscore the need for this Court to grant certiorari.

C. The Legislative History Of Section 13(e) Demonstrates That Rule 13e-3 Was Not Promulgated Pursuant To Section 14(a).

The government's theory that Section 14(a) controls the case at bar is contrary to the legislative history of Section 13(e). That legislative history establishes that Section 13(e) was enacted because Congress and the Securities and Exchange Commission believed the SEC lacked the authority to issue rules like Rule 13e-3 under then existing law including Section 14(a).

The principal opposition to enactment of Section 13(e) centered on the same argument made by the government now: that the SEC had authority to regulate going-private mergers under provisions of the then-current law such as Section 14(a).[1] Congress rejected these argu-

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[1] Testimony arguing that the SEC already had the authority it sought was presented by representatives of the American Stock Exchange, National Association of Securities Dealers, and Investment Bankers Association of America as well as a leading securities lawyer. *See Full Disclosure of Corporate Equity Ownership and in Corporate Takover Bids: Hearings on S. 510 Before the Sub-*

ments and enacted Section 13(e) as part of the Williams Act in 1968. *See* S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967) (provisions of Williams Act designed to close gaps in existing law).

In doing so, Congress relied on the testimony of the SEC that the Commission lacked sufficient authority to regulate going-private mergers under Section 14(a) and other provisions of then-existing law. As SEC Chairman Manuel Cohen testified before the Senate:

> The provisions of this bill would make it unlawful for an issuer to purchase its own securities in contravention of rules or regulations which the Commission adopts because they are necessary or appropriate in the public interest, or to protect investors, irrespective of the question whether, or our ability to prove that, such activity is or may be fraudulent, deceptive or manipulative. The language, for this reason, is broader in its scope than presently applicable provisions of the Exchange Act.[2]

Thus, the government's theory in this litigation that Section 14(a) was the source for the issuance of Rule 13e-3 cannot be reconciled with the SEC's own position in supporting enactment of Section 13(e) more than thirty years after Section 14(a) was enacted. Nor can it be reconciled with Congress' understanding that the Commission lacked such authority under then-current law.

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comm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 66, 101, 108, 162-63 (1967) [hereinafter *Full Disclosure Hearings*].

[2] *Full Disclosure Hearings*, *supra* note 1, at 27. Cohen used virtually identical language before the House. *See Takeover Bids: Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 15 (1968).

D. The Regulatory History Of Rule 13e-3 Also Demonstrates That It Was Not Promulgated Pursuant To Section 14(a).

Obviously, the fact that Rule 13e-3 was given the prefix 13e, rather than 14a, indicates that the SEC relied on Section 13(e) to promulgate the rule. Critical to the government's contrary argument is the assertion that "the Commission expressly relied on Section 14(a)" in the 1979 release promulgating Rule 13e-3. (Brief for United States at 6.)

In fact, the 1979 release does not support the government's argument. Although Section 14(a) was listed as one source of authority, that passing reference was contained in a laundry-list of seven provisions of the Securities Exchange Act and two sections of the Securities Act. *See* Exchange Act Release No. 16075, 17 S.E.C. Dkt. 1449, 1470 (Aug. 2, 1979). Surely an agency cannot create a private right to sue under a newly-promulgated regulation by magically citing any statute which might give rise to a private damages action. If that were the law, any of the numerous SEC regulations which merely list Sections 10(b) or 14(a) as being among the SEC's sources of statutory authority would also become enforceable through private damages actions.[3]

Moreover, an earlier release proposing Rule 13e-3 suggests that Section 14(a) was *not* the primary statutory source being relied on, by singling out two other provisions, including Section 13(a), for extended discussion. Exchange Act Release No. 14185, 13 S.E.C. Dkt. 839, 845

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[3] *See, e.g.*, Securities Act Release No. 33-6578, 32 S.E.C. Dkt. 1280, 1293 (Apr. 23, 1985) (citing Section 14(a) as one of eight statutory provisions purportedly authorizing promulgation of Form S-4, to be used in discussing business combinations in prospectuses); Exchange Act Release No. 16384, 18 S.E.C. Dkt. 1053, 1091-92 (Nov. 29, 1979) (citing Section 10(b) as one of six statutory provisions purportedly authorizing promulgation of Schedule 14D-9, to be used in certain solicitations and recommendations with respect to tender offers).

(Nov. 17, 1977). The Commission emphasized that Section 13(e) was "designed to 'correct the current gap in our federal securities laws by amending the Securities Exchange Act.'" *Id.* at 846 (quoting S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967)). Section 13(e), not Section 14(a), was cited as authorizing the Commission to take the type of action at issue in this case: issuing rules "to prescribe means reasonably designed to prevent acts and practices that are fraudulent, deceptive or manipulative." 13 S.E.C. Dkt. at 847 (footnote omitted). The SEC described this authority as "parallel to that vested in the Commission under Section 15(c)(2) of the Exchange Act" and did not even mention Section 14(a). *Id.* at 847 n.37.

Thus, the history of Rule 13e-3 demonstrates that Section 13(e), not Section 14(a), was the principal statutory source for the regulation.

E. The SEC Has Itself Recognized That Any Private Right To Enforce Rule 13e-3 Must Derive From Section 13(e).

The government's position in this litigation is also contrary to the SEC's historical view since 1977 that any private right to enforce Rule 13e-3 must derive from Section 13(e). In first proposing Rule 13e-3, for example, the SEC maintained that courts should construe Section 13(e) "in such a way as to imply a private right thereunder." Exchange Act Release No. 14185, 13 S.E.C. Dkt. 839, 857 (Nov. 17, 1977). Similarly, in promulgating Rule 13e-3, the SEC announced that it continued to adhere to its position favoring "the implication of a private right of action under Section 13(e) of the Exchange Act" notwithstanding intervening decisions of this Court. Exchange Act Release No. 16075, 17 S.E.C. Dkt. 1449, 1450 n.3 (Aug. 2, 1979). Nowhere in either release did the SEC ever suggest the position it takes now that such a cause of action arises under Section 14(a).

In sum, the government's effort to avoid the question of whether Section 13(e) creates a private cause of action overlooks the history of Section 13(e) and Rule 13e-3. That history establishes that Rule 13e-3's roots are not in Section 14(a), but in Section 13(e). Thus, the Sixth Circuit cannot be said to have decided the Section 13(e) question unnecessarily and that question is properly before this Court.

II. THE GOVERNMENT IS ASKING THIS COURT TO EXTEND *BORAK*.

This Court's decision in *J.I. Case Co. v. Borak* "has been repudiated" by subsequent Supreme Court decisions announcing a more restrictive standard for finding private causes of action. *LeVick v. Skaggs Companies*, 701 F.2d 777, 779 (9th Cir. 1983). Yet the government seeks to extend *Borak* to create new causes of action. As Justice Powell has urged, *Borak's* anomalous status in this Court's decisions "militates strongly against its extension beyond the facts of the case." *Cannon v. University of Chicago*, 441 U.S. 677, 735 n.6 (1979) (Powell, J., dissenting).[4]

There can be no doubt that establishing a private right to enforce Rule 13e-3 would constitute an extension of *Borak*. *Borak* itself held only that a stockholder could seek damages to challenge a merger effected through a "proxy statement alleged to contain false and misleading statements" in violation of Rule 14a-9. 377 U.S. 426, 428, 429-30 & n.4 (1964). The two decisions of this

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[4] Even the Sixth Circuit, which took such an expansive view of private causes of action in the case at bar, has expressed "substantial reservations" as to whether *Borak* should be extended to other SEC rules. *Rauchman v. Mobil Corp.*, 739 F.2d 205, 207 (6th Cir. 1984). Similarly, a former SEC General Counsel has emphasized that *Borak* "is no longer useful precedent, and is likely to be limited to its particular facts." H. Pitt, *The Implication of Private Rights of Action Under the Federal Securities Laws*, in 1 Proxy Contests 601, 718 (P.L.I. 1982).

Court applying *Borak* also involved alleged Rule 14a-9 violations. *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 383 (1970). This Court has never before been asked to read *Borak* as making an alleged Rule 13e-3 violation—a technical failure to comply with a disclosure requirement where there has been no false or misleading statement and no omission making any statement false or misleading—actionable by a private claimant.[5]

Moreover, *Borak's* reasoning is wholly inapplicable to Rule 13e-3. The *Borak* Court reasoned that "[t]ime does not permit [the SEC to conduct] an independent examination" of whether a proxy statement is false or misleading. 377 U.S. at 432. But if, as the Sixth Circuit suggested, Rule 13e-3 requires corporations proposing going-private mergers to analyze specified alternative valuation methods in their proxy materials (16a-19a), the SEC can easily verify compliance when corporations file the required proxy statement with the SEC in advance of any solicitation; either a proposed proxy statement discusses the alternative valuation methods listed in the regulation or it does not. This Court should not permit *Borak's* expansion to cover purported violations of rules like Rule 13e-3 when no falsehoods or misleading statements are involved.

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[5] The lower federal courts also have not read *Borak* as broadly as would the government. The language in *Haas v. Wieboldt Stores, Inc.*, 725 F.2d 71 (7th Cir. 1984), cited by the government as establishing a private damages action under Rule 14a-7, is dicta; the Seventh Circuit acknowledged that this Court's decision in *Bell v. Hood*, 327 U.S. 678 (1946), required reversal of the lower court's dismissal even if no damages action was available. *Haas*, 725 F.2d at 73. Although there is some authority for a private cause of action under Rule 14a-8, such decisions recognize that a 14a-8 violation "renders [a] solicitation inherently misleading." *New York City Employees' Retirement System v. American Brands, Inc.*, 634 F. Supp. 1382, 1386 (S.D.N.Y. 1986).

III. THIS COURT SHOULD DEFINE THE SCOPE AND CONTINUING VITALITY OF *BORAK* IN LIGHT OF SUBSEQUENT DECISIONS.

In the twenty-four years since this Court relied on Section 27 of the Exchange Act to find a private right of action under Section 14(a), this Court has severely restricted the authority of courts to find private causes of action.[6] Applying these more restrictive standards, the Court has repeatedly reversed lower court decisions recognizing private causes of action. (*See* Pet. Reply Brief at 2 n.1.) Although this Court has attempted to limit *Borak* to its facts, *Touche Ross*, 442 U.S. at 577, there is a need to reexamine the scope and continuing validity of that decision. First, as demonstrated by the government's effort to broaden *Borak*, there is significant confusion regarding its proper scope. Second, now *Borak* stands as an historical anomaly, out-of-step with numerous subsequent decisions which reject its reasoning.[7]

Petitioners maintain that *Borak* does not control the case at bar since Rule 13e-3 was promulgated pursuant to Section 13(e), not Section 14(a). But if the Court concludes, as the government submits, that Section 14(a) is applicable to alleged Rule 13e-3 violations, this Court should consider whether the result in *Borak* should be maintained in light of subsequent decisions.

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[6] *Compare Borak*, 377 U.S. at 433 *with Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979) *and Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

[7] *See Cannon v. University of Chicago*, 441 U.S. at 736 (Powell, J., dissenting) ("*Borak*, rather than signaling the start of a trend in this Court, constitutes a singular and, I believe, aberrant interpretation"); *Leff v. CIP Corp.*, 540 F. Supp. 857, 863 (S.D. Ohio 1982) ("the Supreme Court has abandoned the *Borak* approach"); Sunstein, *Section 1983 and the Private Enforcement of Federal Law*, 49 Chi. L. Rev. 394, 413 (1982) (characterizing recent decisions as "effectively abandoning the approach of *Borak*").

IV. AT A MINIMUM, THIS COURT SHOULD VACATE THE DECISION BELOW AND REMAND FOR RECONSIDERATION IN LIGHT OF THE ISSUES RAISED IN THIS COURT.

At bottom, the government's brief supports petitioners' view that the decision below cannot be permitted to stand. Whether one accepts the government's view, raised for the first time in this Court, that the Sixth Circuit decided the important private-right-of-action question presented here under the wrong statute, or Nationwide's position that the question was wrongly decided under the right statute, the result is the same: the Sixth Circuit fundamentally erred in implying a cause of action under Section 13(e). Accordingly, if this Court were to conclude that its plenary review is unwarranted at this time, it should vacate the Section 13(e) portion of the Sixth Circuit's judgment for reconsideration in light of the issues raised in this Court.

CONCLUSION

For the foregoing reasons as well as those contained in petitioners' prior briefs, a writ of certiorari should be issued to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

JEFFREY S. DAVIDSON
(Counsel of Record)
DANIEL F. ATTRIDGE
YOSEF J. RIEMER
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 879-5000
Counsel for Petitioners Nationwide Corporation and Nationwide Mutual Insurance Company

Dated: May 26, 1988